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MAIL PROCESSING NETWORK RATIONALIZATION SERVICE CHANGES, 2012

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BRIEF OF INTERVENOR NATIONAL ASSOCIATION OF LETTER CARRIERS, AFL-CIO

Peter D. DeChiara
COHEN, WEISS AND SIMON LLP
330 West 42nd Street
New York, New York 10036-6976

Attorneys for Intervenor National
Association of Letter Carriers, AFL-CIO

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SUBJECT INDEX

Intervenor National Association of Letter Carriers, AFL-CIO ("NALC") respectfully submits this brief in opposition to the service standard changes proposed by the United States Postal Service ("USPS") in the above-referenced case.

STATEMENT OF THE CASE

Pursuant to 39 U.S.C. § 3661(b), USPS requests an advisory opinion from the Commission on its proposal to revise current service standards. Primarily, USPS proposes to expand the number of days allowed for the delivery of First-Class Mail.

STATEMENT OF POSITION

NALC strongly opposes the proposed degradation of current mail service standards. Speed of delivery is an important element of the quality of postal service. Degrading the quality of First-Class Mail will inevitably cause demand for it to drop further than it has already, as mailers turn increasingly to alternatives like electronic communications, commercial package services or cheaper mail products like Standard Mail.

The amount of business that USPS will lose as a result of slowing mail delivery is unknown. USPS supplies no overall confidence interval for its projection of a 1.7% drop in mail volume. The confidence intervals it provides for different customer segments are large, meaning the projected drops could be far steeper than the point estimates USPS gives. Moreover, as USPS admits, these confidence intervals are flawed, since they were improperly calculated using a normal distribution.

In any event, USPS's projection of a 1.7% fall off in total mail volume is almost certainly understated. USPS bases its projection on the quantitative market research conducted for it by ORC International ("ORC"). In the Saturday delivery case, the Commission found ORC's market research to be flawed by the inappropriate

downward adjustment it made to respondents' estimates of lost mail volume. Despite the Commission's finding in that case, ORC has insisted on making the same adjustment here and, at USPS's suggestion, has even added an unprecedented second downward adjustment, further minimizing the estimates. The estimate is also improperly skewed downward by USPS's assumption that, contrary to accepted economics and common sense, some postal customers will *increase* their mail use as a result of the proposed degradation of service standards. As in the Saturday delivery case, USPS failed to perform any econometric studies or other alternative analyses to assess how reducing the quality of mail service would impact demand, choosing to base its projections entirely on its flawed market research.

The inevitable loss of business that will result from slowing the mail will almost certainly increase with time, as postal customers adjust their operations in response to the degradation of First-Class Mail and turn increasingly to alternatives. Indeed, USPS admits that the customer response to a reduction in quality may be delayed, meaning that mail volume loss would accelerate in coming years.

Moreover, USPS based its mail loss estimate solely on its proposal to reduce service standards. But slowing the mail is just one element of USPS's misguided effort to try to save itself by reducing the quality of its services or by making them less accessible to its customers. When combined with other planned initiatives, like eliminating Saturday delivery, closing post offices or reducing post office hours, the service changes proposed here will drive away postal customers in droves. Indeed, the "all causes" research that USPS abandoned last year yielded preliminary results showing that multiple USPS cost-cutting initiatives would produce a precipitous decline

in mail volume of over ten percent. A drop of that magnitude could pull USPS down into a "death spiral," where USPS chases ever shrinking mail volume with ever more cost-cutting and quality reductions.

Reducing the quality of USPS's most profitable product – First-Class Mail – is not just a bad business decision. When combined with other USPS measures calculated to drive away customers, it could threaten the viability of the enterprise. For that reason and others, as explained further below, NALC opposes USPS's proposal.

DISCUSSION

I. DEGRADING SERVICE STANDARDS WOULD ALMOST CERTAINLY CAUSE A GREATER DROP IN MAIL VOLUME THAN USPS ANTICIPATES

A. Because Degrading Service Standards Reduces the Quality of Mail Service, Demand for Mail Will Drop

As USPS acknowledges, degrading service standards will cause USPS to lose business. *See* USPS-T-12 (Whiteman), at 7. This makes sense. As NALC witness Dr. Michael Crew explains, speed of delivery is an important attribute of the quality of mail service. *See* NALC-T-1, at 4 n.1; Tr. 4384 (Elmore-Yalch agreeing that objectively a reduction in the speed of mail delivery is a reduction in mail quality). To support this proposition – that speed of delivery matters to postal customers – Crew points to a significant body of literature in postal and regulatory economics. *See* Tr. 3578 (response to USPS/NALC-T1-1 (citing, for example, Crew & Kleindorfer, *The Economics of Postal Service* (1992)). He also cites, as an example, the existence of a 20% price differential in Britain's Royal Mail between quicker first-class mail and slower second-class; that certain customers are willing to pay for the higher-priced first-class mail shows that they value speed of delivery. *See* Tr. 3578 (response to USPS/NALC-T1-1; *see also* http://www.royalmail.com/delivery/business-delivery-options-uk). There

is no reason to believe American postal customers value speed any less than their British counterparts.

Why would postal customers care about the speed of mail delivery? One example: consumers who pay their credit card bills by mail, and who do not have the wherewithal or cash cushion to pay far in advance, care whether their payment arrives in time to avoid late fees. Another example: businesses that invoice their customers, and receive payment, by mail, care about timely collection of payment, to ensure adequate cash flow.[1]

The qualitative market research conducted by ORC for USPS supports the conclusion that customers care about speed of delivery: respondents stated that the change to slower service standards might well cause them to accelerate their shift to the internet, opt for FedEx or UPS for important documents, or eliminate discretionary mailings. *See* USPS-T-12 (Whiteman), at 7. In particular, ORC's qualitative research shows that "larger business customers generally do not support a reduction in service" and that service standard changes would only increase pressure on them to divert billings, payments and other communications to electronic media. *See id.* at 14-15. These responses only make sense if speed of delivery is an attribute that matters to these customers and if they perceive slower delivery times as a reduction in the quality of service.

Basic economic theory teaches that when the quality of a product is reduced, everything else equal, demand for it will fall, unless demand for the product is

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[1] *See generally* J.P. Morgan, *Upcoming Changes at the U.S. Postal Service May Impact Your Bottom Line*, http://www.jpmorgan.com/tss/General/More_Thank_a_Penny_Stamp/1320487485573?M=02693d87-b58f-486c-9b94-c8804cc9a28a.

completely inelastic. *See* Tr. 3648-49 (Crew). There is no reason to believe that demand for First-Class Mail is completely inelastic. Indeed, recent studies, including one by Commission consultant and economist Edward Pearsall, show recent increases in demand elasticities for postal products. *See* Tr. 3664, 3691-92 (Crew).

B. The Lack of Adequate Confidence Intervals Makes USPS's Mail Loss Estimate Highly Uncertain

There is no question that degrading service standards will cause a drop in mail volume. Greg Whiteman, USPS's Manager of Market Research, concedes that as a result of the proposed service standard changes, USPS may lose as much as 2.9 billion pieces of mail, or 1.7% of total volume. *See* USPS-T-12 (Whiteman), at 7. The question is whether USPS may lose much more. Whiteman acknowledged on cross-examination that USPS's projection of a 1.7% drop in total mail volume, based solely on ORC's market research, is an estimate and that "no one really knows if the service changes were implemented what in fact would be the total mail volume drop." Tr. 828.

A confidence interval would have shown the range within which the estimated drop in mail volume would have been expected to fall were ORC's market surveys repeated. *See* NALC-T-1 (Crew), at 11; *see also* Tr. 588-89 (Elmore-Yalch). However, Rebecca Elmore-Yalch of ORC provided no confidence intervals with her testimony. *See* USPS-T-11. When NALC requested a confidence interval for USPS's estimate of a 1.7% drop in total mail volume, Elmore-Yalch responded that such a confidence interval could not be provided. *See* Tr. 524 (response to NALC/USPS-T12-13(a)); Tr. 589-90 (Elmore-Yalch). This lack of a confidence interval for USPS's overall estimate of mail volume loss makes it impossible to accept that estimate with any

certainty. As Dr. Crew put it: "when you can't come up with a confidence interval for your bottom line estimate[,] you've got a problem." Tr. 3670.

ORC did provide confidence intervals separately for national, premier and preferred accounts and for small business, home-based business and consumers. *See* Tr. 521-23 (response to NALC/USPS-T12-13(a)). These show large ranges of possible outcomes, confirming the deep uncertainty of USPS's estimates. For example, ORC's point estimate for First-Class Mail volume drop for preferred accounts was negative 4.61% but the confidence interval shows the lower-bound of the estimate at negative *14.15%*. *See* Tr. 522. As ORC admits, even these confidence intervals were flawed, since they were incorrectly calculated using a normal distribution. *See* USPS-SRT-4 (Elmore-Yalch), at 30 (acknowledging that use of normal distribution "is not correct"). ORC never provided corrected confidence intervals. *See* Tr. 4405 (Elmore-Yalch).[2]

C. ORC's Use of the "Probability of Change" Factor Improperly Reduced Respondents' Best Estimates of Their Mail Volume Loss

USPS's estimate of the drop in mail volume that would result from the reduction in service standards is not only highly uncertain, but almost certainly understated, for a number of reasons. First, ORC improperly reduced respondents' best estimates of their mail volume loss by a "probability of change" factor.

Figure 41 from the testimony of Elmore-Yalch, *see* USPS-T-11, at 49, reproduced below, illustrates, using ORC's hypothetical numbers, how ORC calculated volume change:

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[2] In determining confidence intervals, ORC also improperly failed to weight the estimates given by respondent companies by the size of the companies; large companies would have larger impact than the smaller companies on confidence intervals. See Tr. 3587-88 (response to USPS/NALC-T1-9).

Figure 41: Example of Calculating Volume Change

Estimated 2012 Volume Using First-Class Mail	Estimated 2012 Using First-Class Mail if Revised FCM Standards Had Been in Place	% of Increase/ Decrease in Volume Solely Attributable to Change to FCM Standards	Probability of Change (0–100 scale)	Adjusted Volume of First-Class Mail if FCM Standards Changes are Implemented*
100,000	90,000	50%	50%	97,500
* *(90,000 pieces of First-Class Mail After Change – 100,000 pieces of First-Class Mail Before Change) x (.5) x *.5) + 100,000 pieces of FCM Before Change = 97,500 pieces of First-Class Mail if changes to First-Class Mail if changes to service standards are implemented.*				

First, ORC asked each survey respondent to provide its best estimate of how many pieces of mail it would send in 2012 were the proposed service standards implemented. *See* Tr. 576-77 (Elmore-Yalch); *see* USPS-T-11, at 145 (Question U7A). Figure 41 shows that the respondent estimated a First-Class Mail volume in 2012 of 90,000 pieces if the proposed service standards were implemented, down from 100,000 under the status quo. However, rather than accepting this reduction of 10,000 pieces estimated by the respondent, ORC adjusted the estimate down to 2,500, or 25% of the original estimated loss.

To achieve this adjustment, ORC first multiplied the 10,000 estimated pieces of lost mail by a "probability of change" factor that, in ORC's example in Figure 41, cuts the 10,000 in half. It derived this "probability of change" factor by asking respondents to state the likelihood, on a scale of 0 to 10, that they would either change

the number of pieces of mail they mailed or modify the way the pieces were mailed. *See* Tr. 579 (Elmore-Yalch); USPS-T-11 (Elmore-Yalch), at 143 (Questions U5A, U5B).

ORC used exactly this same "probability of change" factor to reduce estimated mail loss in the "Six-Day to Five-Day Street Delivery and Related Service Changes" case, Docket No. N2010-1. Dr. Crew explained in that case that use of such a "probability of change" factor to adjust downward what was already the respondent's best estimate was inappropriate. *See* Direct Testimony of Dr. Michael A. Crew, NALC-T-4, Docket No. N2010-1, at 6; *see also* Tr. 3621 (Crew). To illustrate how use of the "probability of change" factor is inappropriate, Dr. Crew gives the following example: imagine a group of people asked to predict how often a hundred flips of a coin would land on heads. Most would give an estimate near 50. However, then if they were asked how likely they thought their estimate would be accurate, they would express less than 100% certainty – say, 80%. It would obviously be wrong to multiply this uncertainty factor of 80% by 50 to conclude that the respondents' best estimate of the number of heads would be 40. However, ORC employed exactly this sort of illogic. See NALC-T-1(Crew), at 9.

In the Saturday delivery case, the Commission unanimously agreed that use of the likelihood factor was unsupported:

> The Commission finds that there is not, in the record, any evidence demonstrating the use of a likelihood factor in the way the Postal Service utilizes it. Furthermore, there is no support for the contention that the participant's estimates of their volume responses to five-day delivery were likely to be overstated. Therefore, reducing the estimates using an expected value function or "likelihood factor" is *not appropriate*.

> A likelihood factor may have been appropriate if the Postal Service had constructed the survey in a different manner. If the Postal Service asked participants for the maximum volume response they might anticipate due to the five-day scenario, and then asked for the likelihood of participants reaching that maximum, reducing the estimate by the expected value would be appropriate. However, the Postal Service requested participants' best estimates – estimates that may be biased up or down. Deflating that estimate by an expected value function is *not appropriate.*

Advisory Opinion on Elimination of Saturday Delivery, Docket No. N2010-1 (March 24, 2011), at 112-13 (emphasis added). Nonetheless, ORC and USPS have persisted in their use of the flawed "probability of change" factor, claiming that the Commission's position on the matter is "contrary to accepted market research practice." USPS-SRT-4 (Elmore-Yalch), at 3.

USPS seeks to justify its use of the "probability of change" factor by arguing first that it simply corrects for the tendency of survey respondents to "overstate their reactions" to proposed changes. USPS-T-12 (Whiteman), at 8. However, USPS witnesses were unable to provide a single example of respondents in a quantitative market study overstating their reaction to a reduction in the quality of a service. *See* Tr. 757 (response to NALC/USPS-T12-6(b)); Tr. 651-52 (Elmore-Yalch).

Moreover, there is no basis to conclude that the market research respondents were incapable of giving accurate best estimates. Witness Elmore-Yalch admits that given the respondents' experience with First-Class Mail, and their being the person in the household or business with the most knowledge and experience with the mail, they were the "best forecasters of their future responses to changes in postal services" and that the survey results would "accurately project changes in mailing behavior." USPS-SRT-4, at 22.

On surrebuttal, Elmore-Yalch presents a new argument in defense of the "probability of change" factor, arguing that it is not an "adjustment" at all but simply a "weight" similar to those used in surveys of potential voters, contributors to charity or purchasers of products. *See* USPS-SRT-4 (Elmore-Yalch), at 16. This 11th hour attempt to jettison the word "adjustment" is awkward at best, given that USPS witness Whiteman testified that the respondents' estimates were "*adjusted* by the likelihood of change measure," USPS-T-12, at 19 (emphasis added), and given that Elmore-Yalch's own Figure 41 refers, in the last column, to the "Adjusted" mail volume after application of the likelihood factor. *See* USPS-T-11, at 49.

Moreover, voting, contributing to charity and purchasing particular products are not analogous to mail use. The respondent may fail to vote for the candidate, contribute to the charity or purchase the new product, so it may make sense to discount the respondent's stated intention to engage in the particular activity by the likelihood that he or she may not actually do it. The respondents in the ORC market research, by contrast, are certainly going to use mail in 2012; the only relevant question is by *how much* their mail use will change. There is no basis therefore to adjust downward their best estimate.

Elmore-Yalch explained that in market research, researchers generally avoid the use of weights wherever possible. *See* Tr. 4488 ("you never want to weight if you don't need to weight"). Apparently, however, ORC could not resist the temptation to again apply the improper reduction factor in this case.

Dr. Crew explains that ORC's use of the likelihood factor is also inappropriate because it rests on the questionable assumption that respondents are

capable of giving an accurate or non-biased estimate of probabilities. *See* NALC-T-1 (Crew), at 9-10; *see also* Tr. 3586 (response to USPS/NALC-T1-7). USPS insists that they are, but fails to offer persuasive evidence. Elmore-Yalch cites a National Science Foundation survey that found that just two-thirds of respondents "understand the concept of probability," USPS-SRT-4, at 11, meaning that a third do not. That suggests the very real possibility that a significant number of the respondents in the ORC market research – perhaps a third or more – gave "probability of change" factor estimates without fully grasping the concept of probability.[3]

USPS provides no indication of how much greater its estimate of lost mail volume would have been had it not applied the inappropriate "probability of change" factor. When asked to calculate by how much this factor reduced USPS's estimate of lost mail volume, ORC refused to do the calculation. Admitting no possibility that the Commission was correct in its rejection of the "probability of change" factor, ORC insisted that using data without applying the "probability of change" factor "would be inappropriate and potentially misleading." *See* Tr. 513 (response to NALC/USPS-T11-1); Tr. 584 (Elmore-Yalch).

D. ORC's Use of the Unprecedented "Solely Attributable" Factor Further Improperly Reduced Respondents' Best Estimates of Their Mail Volume Loss

ORC's continued use of the inappropriate "probability of change" factor would have been bad enough, but it then compounded that flaw by adding a second

[3] A study cited by ORC showing that respondents know smokers have a reduced probability of survival, *see* USPS-SRT-4 (Elmore-Yalch), at 13, hardly shows a grasp of the concept of probabilities. It just shows that people know what they are repeatedly told on the warning labels on cigarette packs, in public service announcements and in the media.

factor to reduce respondents' best estimates of mail volume drop: USPS asked survey respondents to indicate what percentage of the mail volume drop they estimated was "solely because of" the proposed service standard changes. *See* USPS-T-11, at 144 (Question U6C). However, the question posed to the respondents to elicit their estimate of mail volume drop asked for an estimate of mail volume "under the First-Class Mail Service standards" proposed. USPS-T-11, at 145 (Question U7A). The respondent was not asked to consider any causes for a possible change in mail volume *other* than the proposed First-Class Mail service standards. *See* Tr. 585-86 (Elmore-Yalch). As Dr. Crew explains, since the question posed to the respondent was already limited to a drop in mail volume caused by the proposed service standard changes, no basis existed to reduce further the estimated drop in mail volume by the "solely attributable" factor. *See* NALC-T-1, at 10.

Elmore-Yalch admits that she knows of no other market research in which such a "solely attributable" factor was used. *See* Tr. 4489. ORC did not use such a "solely attributable" factor in the Saturday delivery case. *See* Tr. 586. Indeed, using it here was not ORC's idea at all; USPS came up with the idea for adding this second factor to further decrease the estimate of mail volume loss. *See* Tr. 586. Far from having any basis in market research or statistical analysis, this "solely attributable" factor was simply USPS's way of having respondents, as Elmore-Yalch put it, do a "gut check" of their estimates. Tr. 588.

Elmore-Yalch claims that the "solely attributable" factor caused only a minimal reduction in respondents' estimates of their mail volume loss, but she failed to substantiate this claim. As with the "probability of change" factor, ORC refused to

calculate and provide for the record how much the "solely attributable" factor reduced the estimate of mail volume loss. *See* Tr. 514 (response to NALC/USPS-T11-2).

E. USPS's Estimate of Mail Volume Loss is Skewed Downward by the Assumption that the Proposed Degradation of Service Standards May Cause Certain Postal Customers to Increase Their Mail Use

Certain respondents in ORC's quantitative market research indicated that in response to USPS's proposed degradation of service standards, they would *increase* their mail use. *See* USPS-SRT-4 (Elmore-Yalch), at 26-27. The responses by these respondents caused USPS's overall estimate of mail volume loss to be less than it otherwise would have been. *See* Tr. 4406-07 (Elmore-Yalch).

The assumption that postal customers will in fact increase their mail use in response to the proposed degradation of service standards flies in the face of established economics, namely that, all else equal, demand for a product will fall if the quality of the product is reduced. *See* Tr. 3629 (Crew). It also flies in the face of common sense: a postal customer would seek alternatives to First-Class Mail, not use it more, if it became slower. Accordingly, there is no reason to assume, as USPS does, that certain customers will increase their mail use.

In her initial cross-examination, Elmore-Yalch had no explanation for how a degradation in service standards could increase mail volume. Tr. 594. She admitted that for her the confidence intervals showing the possibility of an increase were just "an exercise in statistics" and were done "without the context of knowing or being well versed in postal operations." Tr. 594-95.

In her surrebuttal testimony, by contrast, Elmore-Yalch made a valiant, although whole unconvincing effort, to explain why certain postal customers might

increase their mail usage. She speculated, for example, that some customers might increase their mail use simply to help save USPS. *See* Tr. 4408. More seriously, she speculated that USPS's network rationalization might increase the reliability of First-Class Mail. *See* USPS-SRT-4, at 9 ("a more efficient network usually generates more reliability"). But Elmore-Yalch, a marketing researcher with no expertise in postal operations, *see* Tr. 594, lacked any foundation for testifying that reliability of the mail will in fact increase. *See* Tr. 4409-10. Indeed, USPS witness Whiteman testified to the contrary, stating that customers can expect no change in the level of dependability of the mail. *See* USPS-T12-1, at 3. In any event, even if there were a foundation for Elmore-Yalch's assertion that network rationalization may improve the reliability of First-Class Mail, there is zero evidence that such a putative increase in First-Class Mail reliability would be significant enough for customers to notice, let alone to cause them to use First-Class Mail more than they otherwise would. That reliability of First-Class Mail is already high, *see* Tr. 4427 (Elmore-Yalch), and that customers already report being very satisfied with it, *see* USPS-T12-1, at 4, suggests that customers would not likely notice any improvement or increase their mail use.

Lacking any basis to show that mail reliability may in fact improve, Elmore-Yalch asserted that postal customers might increase their mail use because they *perceived* a reliability improvement. *See* USPS-SRT-4, at 27. But Elmore-Yalch failed to explain why slower mail could be perceived as more reliable. She based her assertion on comments that she said were made by certain participants in ORC's qualitative market research. *See* Tr. 4430. But it was ORC itself that introduced the notion into the qualitative market research interviews that the proposed changes in

service standards might cause customers to increase their use of the mail. *See, e.g.,* USPS-T-11, at 75 (Qualitative research moderator's guide asking business customers "If the Postal Service met those standards would you use First-Class Mail more?"); *id.* at 79 (same question for moderator's guide for consumers); *see generally* Tr. 4449 (Elmore-Yalch). Having itself planted the idea among participants that changed service standards might increase mail use, ORC seized on responses it received as the explanation for why in fact degraded service standards might increase mail use.

Elmore-Yalch also speculated that some postal customers already have such low expectations of service standards, or are so unaware of service standards, that they would not be disappointed if the mail moved slower. *See* Tr. 4416-17. But even if some postal customers are currently oblivious to how long it takes a First-Class Mail letter to arrive, that does not explain why they would *increase* their mail use if in fact the mail were made to move slower. At most, it suggests their mailing behavior would be unchanged.

In sum, there is no evidence to support the notion that degrading service standards may cause increases in mail use.

F. USPS Failed to Engage In Any Alternative Analyses as a Check on the Accuracy of ORC's Estimates

At the very least, given the unreliability of ORC's market research and the flawed assumptions on which it rests, USPS should have considered alternative means of assessing how much the proposed changes to services standards might reduce mail volume. As Dr. Crew explains, USPS has a long history of using econometric analysis in various applications, including to measure elasticity of demand. *See* NALC-T-1

(Crew), at 13-14. Econometric studies are very good at controlling for bias, *see* Tr. 3689 (Crew), and very effective in measuring elasticities, *see* Tr. 3675 (Crew).

Elmore-Yalch argues that USPS lacks historical data on changes in specific service attributes and therefore could not have performed an econometric study. *See* USPS-SRT-4, at 34. But USPS could have estimated the value of a reduction in service quality for various customer segments and products and thus estimated how a quality reduction would impact demand. *See* NALC-T-1 (Crew), at 14. Other postal operators have used econometric studies when seeking to assess demand elasticity in connection with contemplated service changes. *See id.*

In addition to suggesting an econometric study, Dr. Crew also suggested that USPS could have estimated change in mail volume under the proposed service changes simply by creating two groups of survey respondents, a controlled group asked to estimate their future mail volume under the *status quo* and a treatment group asked to estimate their future mail volume under the proposed changed service standards. *See* Tr. 3677-78. On surrebuttal, Elmore-Yalch admitted that this approach might be effective, but argued that it would not be feasible to set up test markets where the level of service was changed. *See* USPS-SRT-4, at 35. But Dr. Crew never suggested USPS set up test markets; he simply suggested that the controlled group and treatment group respondents be asked to estimate their respective future mail volumes.

USPS's decision to eschew any alternative analysis puts in further doubt its projections regarding the impact on mail volume of changing first-class mail service standards.

II. USPS'S PROPOSED DEGRADATION OF SERVICE STANDARDS, WHEN COMBINED WITH OTHER USPS COST-CUTTING INITIATIVES, WOULD THREATEN THE VIABILITY OF THE BUSINESS

As explained above, the short-term loss of mail volume that would result from USPS's proposed reduction in service standards would almost certainly be greater than USPS projects. But that is not NALC's central concern. NALC's more basic concern is that the proposed reduction in service standards, over the longer-term, and when combined with other cost-cutting initiatives by USPS, could threaten the viability of the business.

The problem at the core of USPS's approach is that it ignores the impact that its proposal would have on its customers. USPS's decision to reduce its service standards is driven by what it refers to as its "peak load" problem: it needs sufficient capacity to meet peak demand periods but, because its capacity is inflexible, during non-peak periods it ends up having underutilized capacity. *See* USPS-T9 (Smith), at 3. USPS's goal is to reduce the peaks by relaxing its service standard obligations, thus slowing the speed of the mail.

Dr. Crew, a regulatory economist who has studied and written about the "peak load" problem for decades, *see* NALC-T1, at 19, explains that reducing service to customers is not the way to address the problem. *See id.* at 20-21. For example, an electrical utility could address its peak load problem by regularly cutting off customers during peak hours, leaving some or all of them in the dark. *See id.* at 20. The electrical utility might save some money doing so but by depriving its customers of service, it would impose a cost on them that would almost certainly exceed the utility's savings. *See id.*

Reducing service standards would similarly impose a cost on USPS's customers. Mailers deprived of current service standards, for example, may have to truck their mail to a further drop off point to guarantee its arrival by a desired date or might have to redesign their operations so that mail is prepared for drop off earlier. *See id.* at 22; *see, e.g.,* USPS-T-12, at 15 (Whiteman testifying that certain large mailers "projected logistical problems if the nearest plant where they drop large volume mailings is closed"). Businesses that invoice their customers, and receive payment, by mail will suffer the effects of delayed payment. Indeed, J.P. Morgan estimates that the proposed service changes could cost large corporations millions annually as the result of slowed receivables cycles and increase customer payment delinquencies.[4] Nothing in USPS's analysis takes account of these costs that customers will have to bear.

USPS also refuses to see that its reduction of service standards would constitute a real price increase. *See* Tr. 839 (Whiteman, denying that "a reduction in service would amount to a de facto price increase"). As Dr. Crew explains, the speed of mail delivery is an important attribute of product quality; slower mail means a decline in its quality. *See* NALC-T-1 (Crew), at 4 n.1. Providing customers an inferior product for the same amount of postage constitutes a real price increase. *See* NALC-T1, at 22-23; PR-T-1 (Neels), at 13 ("when the quality of a product gets worse, such as a longer delivery time standard, the quality-adjusted price rises"). By refusing to acknowledge the real price increase that it is imposing on its customers, USPS is ignoring the cost that its proposal will make them bear.

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[4] *See generally* J.P. Morgan, *Upcoming Changes at the U.S. Postal Service May Impact Your Bottom Line*, http://www.jpmorgan.com/tss/General/More_Thank_a_Penny_Stamp/ 1320487485573?M=02693d87-b58f-486c-9b94-c8804cc9a28a.

USPS witness Whiteman testified that "[n]early all" market research respondents said they would "like to see accompanying improvements in customer service to offset their loss in delivery service." USPS-T-12, at 12. USPS admits, however, that it has no plans to make any such improvements in customer service. *See* Tr. 754 (response to NALC/USPS-T12-3). In short, USPS plans to give its customers less for their money with nothing in return.

USPS's quantitative market research says nothing about how mail volume may drop after 2012. Tr. 588 (Elmore-Yalch). The inevitable loss of business that will result from USPS's proposal will almost certainly increase with time. In the short run, many postal customers may not have time to adjust their operations in response to reduced First-Class Mail service standards. *See* Tr. 3661 (Crew). Moreover, as Whiteman explained in his testimony, "customers experience some amount of inertia when faced with change," so their response "may be inhibited or delayed." USPS-T12, at 8. In the longer term, postal customers would have time to adjust to the reduced quality of First-Class Mail, *see* Tr. 3661 (Crew), and would overcome their initial inertia. When they did, they would move more and more to alternatives such as electronic communications, commercial delivery services or cheaper postal products like Standard Mail, *see* Tr. 3604 (response to USPS/NALC-T1-19(e)(iii)), causing an acceleration in the loss of First-Class Mail volume. *See* NALC-T-1 (Crew), at 6 (noting that the "estimated mail volume drop in 2012 would likely just be the beginning").

This accelerating loss of mail volume would truly snowball when and if the degraded service standards were combined with other USPS cost-cutting measures, like the elimination of Saturday delivery, the closure of post offices and the reduction of

post office hours, *see* Docket N2012-2, USPS-T-1 (Day), at 9, all measures that further reduce the quality of USPS's services or make them less accessible. Indeed, in its "all causes" market research, which looked at the combined impact on mail volume of various USPS plans, like ending Saturday delivery and closing post offices, *see* Tr. 597 (Elmore-Yalch), ORC reached preliminary results showing that First-Class Mail volume would drop a precipitous *10.2* percent. *See* Tr. 844 (Whiteman). That study, left unfinished after USPS pulled the plug on it, *see* Tr. 598 (Elmore-Yalch), shows how the proposed service standards changes, when combined with these other cost-cutting measures, could well suck USPS into a "death spiral" of rapidly diminishing mail volume, followed by more reductions in services, followed by yet further shrinkage of mail volume. The proposed service standard changes therefore could be the first step that leads inexorably to the loss of viability of USPS's business. *See* NALC-T-1, at 3 (Dr. Crew testifying that the proposal "may herald the death knell for the Postal Service").

III. USPS OVERESTIMATES THE SAVINGS THAT ITS PROPOSAL WILL GENERATE

The true danger in this case, explained above, is that USPS is disregarding the massive mail volume loss, and thus revenue drop, that its proposed service changes may trigger. However, that is not the whole story. We also note that USPS's savings estimates are almost certainly overstated.

First, to the extent the degradation of First-Class Mail service standards would cause demand and therefore volume to drop, USPS will have to spread its fixed costs over less volume. *See* NALC-T-1 (Crew), at 15. As Dr. Crew explains, as USPS's average costs rise, USPS would have to generate greater and greater costs

savings to stay ahead of the curve. *See id.* Relentless cost-cutting, in turn, would drive away customers, leading to the "death spiral."

Moreover, USPS's estimate of its cost savings in this case are based to a large extent on its assumption that reducing service commitments would allow it to use its mail processing machinery and its labor more productively. *See* USPS-T-10, at 11, 17 (Bradley). However, this presumed productivity gain is misleading. Since USPS is proposing to reduce the quality of its First-Class Mail service, the product that USPS will be providing after implementing the changes will be a lower-quality product. Dr. Crew explains that comparing USPS's productivity producing a higher-quality product to its productivity producing a lower-quality product is an apples-to-oranges comparison. *See* NALC-T-1, at 16 (Crew).

In addition, USPS takes little account of transition or implementation costs. In response to a NALC interrogatory, USPS gave what it called a "preliminary" estimate of capital costs of facility modifications and material handling projects of $191 million and costs of transporting equipment of $124 million. *See* NALC-T-1 (Crew), at 16 (referring to response by USPS witness Masse to NALC/USPS-T2-2). In addition, USPS saw some one-time costs of relocating employees of around $6,000 per capita. *See id.* USPS conceded that there would be other costs but did not expect them to be "material." *Id.*

Dr. Crew explains that USPS's estimates are based on an extremely optimistic scenario, with implementation costs being very small and effectively one-time only. *See* NALC-T-1 (Crew), at 16. There is a very real possibility, however, that the transition costs of a major change of this kind are likely to be significant. *See id.* at 16-

17. The literature on project implementation suggests that when an enterprise undergoes a major change in its operations, transition costs, which often arise unexpectedly, can be substantial, especially for large projects. *See* NALC-T-1 (Crew), at 17 & n.3. USPS is an enormous, complex organization. Rationalizing the network as USPS proposes would impact virtually every aspect of the Postal Service: many facilities would be closed and the remaining facilities would likely have to be reorganized to handle a higher volume. *See id.* at 17. USPS's proposed changes would impact the transporting, storing, processing and delivery of mail, interactions with senders and recipients of mail, and the potential reassignment or redeployment of many employees. *See id.* It is difficult to imagine how such a monumental change in the USPS's operations would not give rise to logistical glitches, as well as problems in modifying information systems and other elements of operations and infrastructure support. *See id.* at 17-18. These problems could produce unexpected and substantial costs, not only internally but also to its customers. *See id.* at 18.

Moreover, contrary to USPS's optimistic view, the transition costs would not likely be incurred entirely in the first year. *See id.* at 18. To the extent the Postal Service is underestimating the transition costs of its purported network consolidation and service standard changes, it is further overestimating the savings that it would realize.

PROPOSED FINDINGS AND CONCLUSIONS

1. Degrading service standards will cause USPS to lose business. See USPS-T-12 (Whiteman), at 7.

2. Speed of delivery is an important attribute of the quality of mail service. See NALC-T-1, at 4 n.1; *see supra* pp. 3-4.

3. USPS's estimate of the drop in mail volume that would result from the reduction in service standards is highly uncertain given the lack of a confidence interval for the estimate of total mail volume loss and the large, and flawed, confidence intervals provided for particular customer segments. *See supra* pp. 5-6.

4. ORC's use of the "probability of change" factor to adjust downward respondents' best estimates of mail volume loss was inappropriate. *See supra* pp. 6-11.

5. ORC's use of the unprecedented "solely attributable" factor to adjust downward respondents' estimates of mail volume reduction was inappropriate. *See supra* pp. 12-13.

6. USPS's estimate of mail volume loss was improperly skewed downward by the assumption that the degradation of service standards would cause certain postal customers to increase their mail use. *See supra* pp. 13-15.

7. USPS's loss of business resulting from degrading service standards will likely increase with time, as customers adjust their operations in response to the degraded service standards and overcome their initial inertia. *See supra* pp. 19-20.

8. When combined with other USPS cost-cutting measures like the elimination of Saturday delivery, the closure of post offices or the reduction in post office hours, the reduction of service standards will likely lead to a precipitous decline in mail volume. *See supra* p. 20; Tr. 844 (Whiteman).

9. USPS's estimates of its cost savings are almost certainly overstated. *See supra* pp. 20-23.

10. USPS's analysis ignores the significant cost that its proposed degradation of service standards would have on its customers. *See supra* p. 17.

11. Reducing service standards without also reducing nominal postage rates would constitute a real price increase to postal customers. *See* NALC-T-1 (Crew), at 22-23; PR-T-1 (Neels), at 13.

12. Nearly all the market research respondents said they would like to see improvements in customer service to offset their loss in delivery service, *see* USPS-T-12 (Whiteman), at 12, but USPS has no plans to make any such improvements in customer service, *see* Tr. 754 (response to NALC/USPS-T12-3).

13. To the extent the degradation of First-Class Mail service standards would cause demand and therefore volume to drop, USPS would have to spread its fixed costs over less volume. *See* NALC-T-1 (Crew), at 15.

14. USPS overstates its productivity gain since the product that USPS will be providing after implementing the changes will be a lower-quality product. *See* NALC-T-1, at 16 (Crew).

15. USPS almost certainly is underestimating the transition or implementation costs that will be incurred with its network rationalization plan and proposed service standard changes. *See* NALC-T-1, at 16-18.

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Respectfully submitted,

Peter D. DeChiara
/s/ Peter D. DeChiara
COHEN, WEISS AND SIMON LLP
330 West 42nd Street
New York, New York 10036-6976

Attorneys for Intervenor National
Association of Letter Carriers, AFL-CIO